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Supreme Court of the United States

October Term, 1931.

No. 714.

WALTER J. MacDONALD, Trustee in Bankruptcy of Craig, Reed & Emerson, Inc.,
Petitioner Herein,

v.

PLYMOUTH COUNTY TRUST COMPANY,
Respondent Herein.

In the matter of Craig, Reed & Emerson, Inc., Bankrupt.

BRIEF OF RESPONDENT, PLYMOUTH COUNTY TRUST COMPANY.

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Of Counsel:
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LAWYERS' BRIEF & PUBLISHING CO.
BOSTON, MASS.

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BRIEF OF RESPONDENT, PLYMOUTH COUNTY TRUST COMPANY.

Statement of Facts.

Craig, Reed & Emerson, Inc., was a Massachusetts corporation engaged in manufacturing shoes at Brockton, Massachusetts.

The Plymouth County Trust Company is a banking institution doing business in Brockton.

Craig, Reed & Emerson, Inc. owed $36,500 for some time to the Plymouth County Trust Company, (Rec. p. 83). On March 8, 1927, the loan was changed from a time loan to a demand loan. (Rec. p. 83.)

Craig, Reed & Emerson, Inc. had its checking account at the Plymouth County Trust Company, and made its deposits there.

In June, 1929, Mr. Cooper, the president of the Plymouth County Trust Company, was asked to come over to the Plymouth Development Company, the office of a Mr. Davis, a preferred stockholder of Craig, Reed & Emerson, Inc. When Mr. Cooper arrived at the office of the Development Company, Messrs. Reed, Field and Craig, officers of Craig, Reed & Emerson, Inc. were there, as were the directors of the Plymouth Development Company.

Mr. Davis said that "the object of the meeting was to determine the best way to continue the business of Craig, Reed & Emerson, Inc. for the next few months at the smallest possible loss." (Rec. p. 58.)

Mr. Cooper, although present, did not speak (Rec. pp. 58, 59), and did not agree to anything. (Rec. p. 85.)

Subsequent to this conference, the business of Craig, Reed & Emerson, Inc. was conducted as usual, and deposits were made in the usual course of business by Craig, Reed & Emerson, Inc. in the Plymouth County Trust Company. (Rec. pp. 50, 51, 82.)

On July 11, 1929, Craig, Reed & Emerson, Inc. deposited in the Campello Branch of the Plymouth County

Trust Company $15,100.78 in the form of checks drawn on New York. (Rec. pp. 35, 45; Exhibit 5, p. 101.)

Either on the same day, or on the morning of the 12th of July, the checks arrived at the main office of the bank. (Rec. p. 45.)

On the 12th day of July, 1929, there was on deposit in the Plymouth County Trust Company to the account of Craig, Reed & Emerson, Inc., $5,140.87 collected funds (Rec. p. 69), and the uncollected checks of $15,100.78 drawn on New York.

On July 12, 1929, after the $15,100.78 checks arrived at the main office of the bank, the bank offset $4,027.29 and $15,100.78 and made proper entries on July 12, 1929, showing the offset of $4,027.29, but did not make the offsetting entries of the $15,100.78 checks until July 13th, when the checks had cleared. (Exhibit 6, p. 103; Rec. pp. 45, 69, 81.)

On July 12, 1929, $375 was also charged against Craig, Reed & Emerson, Inc., for rent due July 1st. (Rec. pp. 43, 44, 47, 48, 73.)

On July 15, 1929, $1,348.72 was set-off by the bank, which was the amount of the balance remaining in the bank from July 12th in collected funds, plus uncollected checks of $346.76 and $316.56 deposited on July 15th. (Rec. pp. 41, 42.)

On July 16, 1929, Craig, Reed & Emerson, Inc. made a general assignment for the benefit of its creditors to L. H. Hall, assistant treasurer of the Plymouth County Trust Company (Rec. p. 25), and on the 28th day of Sep-

tember, 1929, an involuntary petition in bankruptcy was filed against Craig, Reed & Emerson, Inc. The company was adjudicated bankrupt on the 14th day of October, 1929, and subsequently Walter J. MacDonald was appointed trustee. (Rec. p. 1.)

The trustee filed a petition with the referee in bankruptcy to have the Trust Company turn over to him $20,476.79, claiming the same to be preferences. (Rec. p. 2.)

The Trust Company consented to the jurisdiction of the Referee, with the understanding that it was to be tried as a plenary suit. (Rec. pp. 24, 115.)

The Referee decided (Rec. pp. 6, 7) that the Trust Company had the right to set-off the rent of $375 and the $4,027.29 set-off against the note, but that $16,108.49 was a preference. (Rec. p. 7.)

On review, the District Judge decided that all these amounts were preferences, and entered a decree for the sum of $20,476.79, with interest from December 5, 1929. (Rec. pp. 21, 24.)

On appeal, the Circuit Court of Appeals for the First Circuit reversed the decree of the District Court, leaving the trustee to proceed by a plenary suit in a court of competent jurisdiction. (Rec. p. 118.)

The Circuit Court of Appeals for the First Circuit, reversed the decree of the District Court on the ground *that the Referee in Bankruptcy had no jurisdiction to hear a preference suit.*

The trustee in bankruptcy filed a petition for certiorari, which was granted, and the case is here for argument thereon.

Assignment of Errors.

The assignment of errors presents the following questions:

1. Was there any evidence to warrant the finding that Craig, Reed & Emerson, Inc. was insolvent on the 12th, 13th, 14th or 15th of July, 1929?

2. Was the set-off of $4,027.29 on July 12, 1929, a preference?

3. Was the set-off of the rent of $375 on July 12, 1929, a preference?

4. Was the set-off of the proceeds of the $15,100.78 checks received by the bank on July 11, 1929, a preference?

5. Could the parties, by consent, confer jurisdiction on the Referee to hear a plenary suit to recover a preference?

Argument.

I.

There was no evidence to prove insolvency of Craig, Reed & Emerson, Inc., on July 12, 13, 14, or 15, 1929.

> "A person shall be deemed insolvent within the provisions of this Act, whenever the aggregate of his property . . . shall not, at a fair valuation, be sufficient in amount to pay his debts."
>
> *Bankruptcy Act,* sec. 1, cl. 15.

> "A fair valuation means the actual value . . . its real market value . . . It is what the property would sell for in the regular course of business, but not what the property would sell for at forced sale."
>
> *Loveland* (4th ed.) p. 302.

> "A man's property at fair valuation may amount to sufficient to pay his debts, although he might not be able to realize at once the amount of that valuation."
>
> *Duncan v. Landis,* 106 Fed. 839, 861.

> "The valuation for a test of solvency or insolvency under the issue, must relate to the conditions as a going concern when the alleged preference was given, and not to the mere dead matter of the plant after bankruptcy intervened."
>
> *Butler Paper v. Goembel,* 143 Fed. 295, 297.

There was not a scintilla of evidence showing what the value of the assets was on July 12, 13, 14 or 15, 1929. To be sure, there is a statement of the witness, Craig, that "there was no substantial change in the affairs of the company between July 16th and August 21st." (Rec. p. 92.)

There was the further evidence that the assignee, on August 21, 1929, issued a statement to the creditors showing that the assets were $88,531.36 and the liabilities were $58,016.36. (Rec. pp. 16, 26, 92, 94; Exhibit 10, p. 104a.)

The assignee conducted the business and then sold the assets, apparently at private sale, on the 27th day of September, 1929, (Rec. pp. 27, 28, 29), the day before the filing of the involuntary petition in bankruptcy. There was no evidence introduced to show that the fair value of the assets was the same on September 27, 1929, as on July 12, 1929, nor was there any evidence to show that there had not been a material change.

Over the objections of counsel for the appellee (Rec. pp. 29, 30) the purchase price of $14,330.61 was admitted.

The Referee adopted this purchase price as the fair value of the assets on July 12, 1929, without the introduction of any evidence to enable him to reach that conclusion, and he also used the schedules in bankruptcy as evidence, without their having been introduced as an exhibit. (Rec. p. 17.).

Fair valuation does not mean "scrap or wrecker's value," and the admission of the purchase price without being further connected with the fair value at the date of the alleged preferences was erroneous.

Eaton v. Standard Oil Co., 100 Conn. 443.
Swartz v. Frank, 183 Mo. 438,

where the Court says:

> "The general rule of law is that a state of facts once shown to exist is ordinarily presumed to continue

so to exist until the contrary is shown. But this presumption is not retrospective . . . The Court has no more right to presume that the company had the same amount of stock on hand on December 19th as it was shown to have had on December 26th than it would have to presume that the amount on hand on December 19th was either greater or smaller than the amount on hand on December 26th . . . *The law requires proof and does not indulge in speculation.*" [Italics ours.]

The trustee, in order to prevail, must prove as part of his case what the fair value was of the assets on *the date* of the alleged preference. This is part of the burden which he assumed.

II.

The set-off of $4027.29 was not a preference.

Admittedly there was on deposit in the Plymouth County Trust Company on the 12th day of July, 1929, to the credit of Craig, Reed & Emerson, Inc., $5140.87 in collected funds. (Rec. p. 69, Exhibit 6.)

Admittedly there was no collusion between Craig, Reed & Emerson, Inc. and the bank; Craig, Reed & Emerson, Inc. did not make deposits for the purpose of preferring the bank, and the bank did not solicit or prevail upon the depositor to make deposits so that it could be preferred. The deposits creating this balance were made in the usual course of business. (Rec. pp. 82, 89, 59, 60.)

The Referee has found that this set-off of $4027.29 was not a preference. (Rec. pp. 6, 7.) The District Judge, however, disallowed the set-off, believing that *Bailey v. Merrimac National Bank,* 283 Fed. 514, 516 (affirmed 289 Fed. 468), governed the case. (Rec. p. 24.)

In the *Merrimack* case a creditors' committee *took charge* of the company's business, and the bank consented to an extension. The Court found that the bank did not act in good faith, and further that there was no usual course of business, as the insolvent's business was then shut down.

The case of *Citizens National Bank of Gastonia v. Lineberger,* 45 Fed. (2d) 522, seems to be almost identical with the case at bar, and follows the decision in the case of *New York County Bank v. Massey,* 192 U. S. 138, where the Court said:

> "There is nothing in the findings to show fraud or collusion between the bankrupt and the bank with a view to create a preferential transfer of the bankrupt's property to the bank, and in the absence of such showing, we cannot regard the deposit as having other effect than to create a debt to the bankrupt and not a diminution of his estate."

The Court further held that an ordinary deposit in the bank "is not a transfer."

Studley v. Boylston National Bank, 229 U. S. 523.

III.

The set-off of $375 for rent was not a preference, as it was the usual way in which the rent was handled, and this $375 set-off was merely a set-off for the rent which fell due July 1, 1929 (Rec. pp. 47, 48).

IV.

The set-off of the proceeds of the $15,100.78 checks was not a preference.

There was no collusion between the bank and the depositor with reference to the deposit of the $15,100.78 in checks in the Campello branch of the bank on July 11, 1929. The officials of the bank did not even know that the checks had been received at the branch until they were received at the main office of the bank on July 12th, (Rec. pp. 89, 90.)

The Referee's certificate and findings thereon are based on the erroneous premise that the receipt of the $15,100.78 in checks was after the memorandum, to wit: "Show all checks and deposits to Mr. Crocker" had been put on the ledger card (Exhibit 6).

An analysis of the testimony shows that a Mrs. Mills placed that memorandum on the card upon the instructions of Mr. Crocker, a vice president of the bank. Mr. Crocker testified that the memorandum was put on some time after July 13th (Rec. p. 76), because he had it put there in order to enable him to see that the laborers' checks were paid (Rec. p. 77) as "one of the laborers had obtained counsel and was about to start suit on the check" (Rec. p. 77).

Mrs. Mills, on cross examination, emphatically testified (Rec. p. 64) that she could not tell the exact date when the memorandum was put on.

This is all the testimony with reference to the date of the memorandum.

(a)

THE BANK HAD A BANKER'S LIEN ON THE CHECKS WHEN THEY WERE DEPOSITED.

Joyce v. Anten, 179 U. S. 591 at 597:

"It is familiar law that a bank receiving notes for collection is entitled, in the absence of a contract expressed or implied to the contrary, to retain them as security for a debt of the party depositing the notes."

Jones on Liens, sec. 242:

"The lien of bankers is part of the law merchant, and the courts are bound to take judicial notice of it, just as they are bound to recognize the negotiability of bills of exchange."

Prudential Realty Co. v. Commissioner of Banks, 241 Mass. 277, 279.

National Bank v. Insurance Co., 104 U. S. 54, at 71.

Studley v. Boylston National Bank, 229 U. S. 523.

Furber v. Dane, 203 Mass. 108 at 117:

"There is no doubt that under ordinary circumstances, a bank has the right to apply the deposit of an insolvent debtor toward the payment of its claim against him . . . This right of detention or banker's lien, as it is some times called, attaches upon the securities and moneys of the customer deposited in the usual course of business for advances which are supposed to have been made upon their credit."

Kane et al. v. First National Bank of El Paso, Texas, C. C. A. 5th, decided March 3, 1932, No. 6258 (not reported as yet.)

(b)

THE BANK HAD THE RIGHT TO OFFSET THE PROCEEDS.

New York County Bank v. Massey, 192 U. S. 138.
Studley v. Boylston National Bank, 229 U. S. 523.

Fourth National Bank v. Smith, 240 Fed. 19:

"Knowledge by the bank of the insolvency of the depositor at the time of making the set-off does not invalidate the set-off. Indeed, in most cases, such knowledge is the very reason for making the set-off . . . In the *Massey* case . . . the bank knew of the insolvency of the depositor before the set-off was made."

In order for the bank to be deprived of its right of set-off, there must be collusion between the depositor and the bank, participated in by both.

Germania Savings Bank & Trust Co. v. Loeb, 188 Fed. 285; 26 A. B. R. 238:

"A careful consideration of the records constrains us to the opinion that there was no fraud or collusion between the bank and the bankrupt for the purpose of creating a preferential transfer with respect to the deposit balance in question. It is not, and could not be contended that there was any collusion in respect to creating this balance."

At 247, the Court says:

"It is true that on and after the 5th day of February, the bank had reason to believe that the Mercantile Company was insolvent. It is also true that the application upon the bank's debt of this balance of deposit, accumulated after notice of possible insolvency of the Mercantile Company, in fact enables

the bank to obtain a greater dividend on its claim than creditors generally obtained. But unless it was the intention of the parties to so accumulate the deposits for the purpose of preferring the bank, the transaction did not create a preference under the Bankruptcy Act. This view is supported by the case of *New York County Bank v. Massey, (supra).* As before remarked, a considerable portion of the deposits allowed as a set-off in that case was made after actual knowledge on the part of the bank of the insolvency of its customer."

Rupp v. Commerce Guardian Trust & Savings Bank, 32 Fed. (2d) 234; 14 A. B. R. 1, at 2:

"This balance was accumulated in the bank in the usual course of business, and was not built up or deposited for the purpose of giving a preference to the bank. At the time it was applied to the indebtedness of the Milling Company that company was insolvent. We have no doubt of the right of the bank to make the application upon that basis . . . and it was immaterial to the existence of this right that the debts were not due, as under Sec. 68A of the Bankruptcy Act, the right of set-off is preserved as to provable debts, whether due or not."

V.

A referee has no jurisdiction to hear a preference case.

Weidhorn v. Levy, 253 U. S. 268.

"We find nothing in the provisions of the Bankruptcy Act that makes it necessary or reasonable to extend the authority or jurisdiction of the referee beyond the ordinary administrative proceedings in bankruptcy."

Sec. 23 (b) expressly excepts suits for preferences from the conference of jurisdiction upon the Court *by consent.*

Collette v. Adams, 249 U. S. 545.

> "The exception ingrafted in sec. 23 (b) takes such suits out of the restricted provisions of that section; the sentence added to sec. 60 (b) makes them cognizable in the *Courts of Bankruptcy.*"

Sec. 60 (b) confers jurisdiction for the recovery of a preference "on any court of bankruptcy."

Sec. 1A (8). "Courts of bankruptcy" means the District Court, and does not include the Referee.

In re Walsh Bros., 163 Fed. 352.

In re Ballou, 215 Fed. 810.

> "But though such a suit can be brought in this court with the consent of the corporate petitioner, it cannot be brought before the referee with such consent. The jurisdiction conferred by that section on the District Court cannot be exercised by the Referee."

In re Overholzer, 23 A. B. R. 10.

And all of said cases are approved by this Court in the *Weidhorn* case.

The District Court fails to distinguish between "courts of bankruptcy" and "court" as defined in the Bankruptcy Act.

"Court" (sections 1 (a)-7) includes Referees, but "courts of bankruptcy" (sections 1 (a)-7) does not include Referees.

Congress has been very careful in the use of these words in the Bankruptcy Act, and where the Referee is not to be included, the words "court of bankruptcy" are always used. (See sections 2, 12 (b), 21 (a) and 34 (a).)

Daniel v. Guaranty Trust Co., U. S. Supreme Court, decided March 14, 1932.

(a)

NO AGREEMENT OF PARTIES CAN CONFER JURISDICTION.

Shwartz v. Kaplan, 50 Fed. (2d) 947.
Nixon v. Michales, 38 Fed. (2d) 420.

This was a controversy between strangers to the bankruptcy, heard and decided by the Court of Appeals, and, on rehearing, the case was dismissed on the ground that there was no jurisdiction, and there could be no jurisdiction by consent.

Chi. B. & Q. Ry. Co. v. Willard, 220 U. S. 413.

Conclusion.

It is respectfully submitted that the decision of the Circuit Court of Appeals is correct, and should be affirmed.

Respectfully submitted,

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